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FLEXIBLE TAXATION

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FLEXIBLE TAXATION

OCCURRENCE of a second business recession in the space of three years has given special prominence to proposals, long debated by economists, to introduce some measure of flexibility into the rate schedules of the federal income tax. The purpose would be to make tax policy effective as an instrument for combating recession or inflation. Flexibility would be attained by making statutory provision for downward or upward rate adjustments, either automatically according to a formula based on standard economic indexes or at the discretion of the President.

Several of President Kennedy's key economic advisers, believing that present monetary and fiscal policies do not lend themselves to checking an economic slump with sufficient dispatch, have urged adoption of the flexible system. Some of the management and labor spokesmen who have been calling for an immediate reduction of taxes take a similar position. They advocate amendment of the internal revenue laws to assure tax relief close to the start of future business recessions—not months later when the slump may have gone too far to yield to a remedy of this kind.

The new administration has made it clear that it will not be hurried into an immediate decision on tax recommendations to Congress. President Kennedy said at a news conference on Feb. 1 that he did not at that time consider the current recession serious enough to justify a tax cut. He added that "We are going to make another judgment on the state of the economy in two to three months and will then decide what action can be usefully taken."

A week later, at his Feb. 8 news conference, the President confirmed the administration's intention to "take another look at the economy in April" and said he thought that "We should have more experience and more perspective on the state of the economy before making a proposal [for temporary tax reduction] which is quite far-reach-

ing." He observed that a tax cut probably would cost the government $4 billion or $5 billion in revenue and perhaps limit "our ability to go ahead with other programs which in the long run may be more useful."

Proposal to Empower President to Cut Taxes

Organized labor's proposal for increased flexibility in the federal tax structure was advanced on Jan. 5 by the executive council of the American Federation of Labor and Congress of Industrial Organizations. The council suggested that Congress authorize remission of $5 billion in individual income taxes whenever unemployment rose above 7 per cent of the labor force.[1] The remission would be effected by cutting $10 a week off the amount of individual tax withholdings for a maximum of 10 weeks. An equivalent reduction would be allowed at the end of the tax year to individuals whose income was not subject to tax withholding. Congress, while delegating authority to the President to put the temporary tax cut into effect at his discretion whenever unemployment exceeded the 7 per cent level, would specifically retain the right to veto the President's action.

This plan for a $5 billion tax cut to benefit only individual taxpayers[2] was one of a number of proposals put forward by the A.F.L.-C.I.O. to "halt the decline and provide the basis for a quick boost to sales, production and employment." The assumption that the proposed tax cut would have that effect has been challenged by some economists. They assert that the most important reason for the current economic downturn has been a reduction of inventories attributable to a slackening of inflationary pressures; many companies no longer find it necessary to maintain excess inventories as a hedge against future price increases. "This, coupled with new methods of control, has been far more responsible for the inventory drops than any decline in sales, and thus would not be reversed by a suspension in tax collections no matter how much it stimulated retail buying."[3] It has been pointed out also that while purchases of non-durable goods and of services might be swelled by a tax cut, these are the two areas of private spending that have been holding up well.

[1] The Labor Department reported, Feb. 9, that unemployment in January, computed on a seasonally adjusted basis, affected 6.6 per cent of the civilian labor force.

[2] Individual income taxes yielded $45 billion in fiscal 1960, approximately twice the yield of $22 billion from corporation income taxes the same year.

[3] *Journal of Commerce and Commercial*, Dec. 20, 1960, p. 4.

Tax Reductions in Previous Business Downturns

Previous efforts to reverse economic downturns with a tax cut offer no clear guide for the present. Following the stock market crash of October 1929, President Hoover recommended immediate reduction of federal income taxes on both individuals and corporations to encourage business activity. A joint resolution of Congress, approved Dec. 16, 1929, granted a temporary reduction of one percentage point in rates of the normal tax on personal incomes and of the flat tax on corporate incomes. The rate reductions, applicable only to income received in 1929, failed to halt the downward economic spiral and were not renewed.

However, because there was then no withholding tax, the reductions had no direct effect until income taxes for 1929 fell due on March 15, 1930. Furthermore, the reductions for individuals (a total of only $160 million in terms of revenue loss) benefited no more than a small part of the population; the large personal exemptions then allowed ($1,500 for single persons and $3,500 for married persons) restricted the income tax to far fewer individuals than it affects today. Tax reductions which took effect during the business downturns of 1948-49 and 1953-54 lacked elements of anti-recession planning because they were authorized before there was evidence of a slump.[4]

In the spring of 1958 tax cuts to counter the recession that had got under way in 1957 were vigorously opposed by Secretary of the Treasury Robert B. Anderson and other officials of the Eisenhower administration. Two such proposals by Sen. Paul H. Douglas (D Ill.) were defeated by the Senate. The first, calling for income and excise tax reductions to total $5.2 billion, was voted down, March 13, 71 to 14. The second, a $6 billion income-excise tax cut package, was rejected, June 18, 65 to 23.[5] President Kennedy recalled at his press conference Feb. 8 that he had voted against the tax cut proposed in March 1958 and for the tax-cut amendment in June. "The recession was serious," he said. "We ended up with a $12 billion deficit. We are going to take another look at the economy in April and make a judgment at that time whether we can expect

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[4] See "Tax Reduction, 1958," *E.R.R.*, 1958 Vol. I, pp. 308-311.

[5] The party division on the June roll call was Nays: Democrats 24, Republicans 41; Yeas: Democrats 20, Republicans 3. For individual votes on the two roll calls see *Congressional Quarterly Almanac 1958*, pp. 423, 442.

an upturn in the spring or in the summer." He said he was not convinced that Congress would accept a proposal by the administration for a substantial tax reduction now.

VIEWS OF PRESIDENT KENNEDY'S ECONOMIC ADVISERS

Several economic advisers in the Kennedy administration have made strong pleas for a more flexible tax system. Walter W. Heller, chairman of the Council of Economic Advisers, has contended that greater flexibility in the tax structure would enable tax policy to take over a part of the responsibility for combating unfavorable economic trends that is now borne by monetary policy. In a news conference at Palm Beach, Fla., on the day of his appointment last Dec. 23, Heller said that "Ways and means should be explored without advance commitment for moving tax rates in accordance with economic conditions."

> Whether a satisfactory method can be worked out remains to be seen. But it certainly is one of the methods that should be explored for economic stabilization purposes, particularly in the light of the gold outflow, because the gold outflow—the international balance-of-payments position—limits us somewhat in the use of our monetary tools, interest rates, and, as a consequence, I think a fuller exploration of the fiscal tools is in order.

Rigidities in the federal tax structure came in for criticism in the report submitted by a special economic task force 15 days before Kennedy's inauguration. The task force, headed by Paul A. Samuelson, economics professor at Massachusetts Institute of Technology, stated on Jan. 5 that "Prudent economic policy must face the fact that we go into 1961 with business still moving downward." The report urged that a number of "minimal measures" be pushed diligently even if the current recession showed signs of tapering off by summer. The measures included provision of extended unemployment compensation payments, of additional federal funds for urban renewal, health and welfare programs, and school construction, and of aid to economically depressed areas; lowering of interest rates on home mortgages to stimulate home building; acceleration of public works programs; and stepping up of defense and foreign aid spending.

A temporary tax cut was proposed as the most important among various "second line of defense policies" recommended if the economy failed to respond to the initial economic spurs and if unemployment approached the "critical 7.5 per cent level."

> A temporary reduction in tax rates on individual incomes [the Samuelson report asserted] can be a powerful weapon against recession. Congress could legislate, for example, a cut of 3 or 4 percentage points in the tax rate applicable to every income class, to take effect immediately under our withholding system in March or April and to continue until the end of the year. . . . At this time it would be urgently important to make sure that any tax cut was clearly a temporary one. With the continued international uncertainty and with new public programs coming up in the years ahead, sound finance may require a maintenance of our present tax structure and any weakening of it in order to fight a recession might be tragic.
>
> Even if it should prove to be the case that growth makes reduction of tax rates possible in the long run, that should be a decision taken on its own merits and adopted along with a comprehensive reforming of our present tax structure. (Various tax devices to stimulate investment might also be part of a comprehensive program designed to eliminate loopholes, promote equity, and enhance incentives.) [6]

The Samuelson task force brought up the controversial question of whether the President should have authority to continue a reduction of taxes made initially by Congress for a stated period. It favored granting that authority in the present situation.

> In view of the great desirability of introducing greater flexibility into tax rates, it would be highly desirable for Congress to grant to the Executive the right to continue such a reduction for one or two six-month (or three-month) periods beyond that time [end of 1961] (subject to the actions being set aside by joint resolution of Congress) with the clear understanding that the reduction will definitely expire by the end of 1962.

A few weeks before the task force report was made public, Samuelson explained in a magazine interview that granting some discretionary tax-cutting authority to the President or tying tax-rate changes to certain objective indicators of business activity appeared necessary to lessen "the delay that is involved in the congressional procedure." He said: "The present delay is such that the President must look 18 months ahead in preparing his budget and revenue proposals, and then Congress must debate for five months. So you cannot use tax cuts as a precision instrument." [7]

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[6] President Eisenhower said in his last Economic Report to Congress, Jan. 18, that a "selective revision of our tax structure is needed to promote incentives and to maintain the vigor of the enterprise system." He cautioned, however, that "The full benefits of tax revision should not be jeopardized by the hasty improvision of reduction in the hope of countering cyclical downturns in economic activity."

[7] "What To Do About Business Recessions" (copyrighted interview with Paul A. Samuelson), *U.S. News & World Report*, Dec. 26, 1960, p. 54.

Another Kennedy task force, headed by Allan Sproul, former president of the Federal Reserve Bank of New York, endorsed proposals for extension to the President of "discretionary authority to put into effect, for a statutorily limited period, some reduction in tax rates." The Sproul task force said in its report, made public Jan. 25, that "The temporary reduction should be of limited amount, of relatively simple structure, and as 'neutral' as possible in its impact on different groups."

John Kenneth Galbraith, Harvard economist and Democratic campaign adviser, has said the nation "badly need[s] some flexible instrument of fiscal policy—perhaps the executive power to suspend taxes on the lower income (and assured spending) brackets when demand must be increased and to end the suspension when the need for stimulation passes." [8] Galbraith believes that monetary policy has been too slow-working and undependable an instrument to maintain economic equilibrium. "The effect of a particular change in interest rates on borrowing for investment spending is highly unpredictable," he wrote. "It was excessive reliance on this highly unpredictable instrument that brought us the postwar recessions."

Other economists think that monetary controls are the primary economic stabilizers. But there is wide agreement with the Samuelson report's conclusion that substantial easing of credit conditions in the present recession "must await a solution of our international difficulties," specifically the outflow of gold. Any significant lowering of interest rates, it is contended, would encourage increased investment of American capital abroad.[9]

Reluctance of Congress to Delegate Tax Power

Suggestions by presidential advisers and by labor leaders that Congress give the Chief Executive discretionary authority over tax rates have had a chilly reception on Capitol Hill. Article I, Section 8, of the Constitution provides that "The Congress shall have power to lay and collect taxes, duties, imposts and excises." The power to levy taxes is one of the basic constitutional powers of the Legislative Branch which has not been whittled down by force of circumstances or been voluntarily surrendered. As a political

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[8] Statement in special article for *Washington Post*, Jan. 20, 1961.

[9] See "Gold and the Dollar," *E.R.R.*, 1960 Vol. II, pp. 921-938.

commentator recently observed: "The war declaring power has been eroded with the coming of surprise attack. The tariff power has gradually been delegated in considerable measure to the President. And now Samuelson wants to delegate, in effect, some of the tax power." [10]

Douglas Dillon was quizzed on this aspect of the Samuelson report at a Senate Finance Committee hearing, Jan. 11, on his nomination to be Secretary of the Treasury. He remarked that it would be "most unusual and unique" for Congress to surrender so much authority over taxation but this was a matter "entirely for the Congress to decide." Chairman Wilbur D. Mills of the House Ways and Means Committee, referring to the refusal of Congress to agree to a big tax cut during the 1957-58 recession, has said:

> Perhaps had we had authority in the law for somebody other than Congress to fix new rates, new rates would have been fixed. Would we have had those old rates of existing law back in effect by now? I don't know whether [persisting unemployment] would have justified a continuation of the lower rates or not. But it imposes too much discretion to institute such a thing in the law, that in a tax system the rates would not be fixed by Congress but would be fixed by someone other than the Congress. I have had great trouble in arriving at that as being a satisfactory way of handling it.[11]

The Supreme Court has held in numerous decisions that Congress may delegate powers of a legislative character if the statute making the delegation prescribes standards and limitations to be observed in exercising the powers. The President's power to alter tariff duties, delegated by the Trade Agreements Act of 1934, has been sustained as meeting this test. The Court long ago cited with approval an opinion by the Ohio supreme court which stated: "The true distinction . . . is between the delegation of power to make the law, which necessarily involves a discretion as to what it shall be, and conferring an authority or discretion as to its execution, to be exercised under and in pursuance of the law. The first cannot be done; to the latter no valid objection can be made." [12]

Fixing of Tax Rates in Great Britain and Canada

In democracies which have a parliamentary form of government, such as Great Britain and Canada, the making of

[10] Chalmers M. Roberts in *Washington Post*, Jan. 8, 1960.

[11] Statement during committee hearings on tax revision, Dec. 18, 1959.

[12] Hampton & Co. v. United States, 276 U.S. 394 (1928). See "The Tariff Power," *E.R.R.*, 1945 Vol. I, pp. 357-360.

the tax law and its administration are both in effect in the hands of the government of the day. Members of the Cabinet are all members of Parliament as well as heads of government departments. The British Chancellor of the Exchequer, for example, decides what the tax rates shall be from year to year, and Cabinet approval of his schedules assures their approval by the House of Commons, for rejection would cause the government to fall. "There is very little room for outside pressure to be brought to bear with such a system. There are no committees, and individual members of Parliament have very little influence unless they want to bring about a fall of the government, which they rarely want to do because then they themselves have to run for election again." [13]

The Canadian government, faced with an economic recession of serious proportions, went before the House of Commons at Ottawa last Dec. 20 with a supplementary budget calling for important tax revisions, several to take effect within 11 days. Minister of Finance Donald M. Fleming voiced his conviction that "Sound budget policies must be flexible and adapted to changing economic conditions." He said also that "A responsible government cannot stand by and allow [economic] events to take their course simply on the ground that budgets are brought down only once a year." The supplementary budget cut corporate income taxes, provided an accelerated depreciation tax schedule, and reduced the surtax on investment income.

The power to take quick action in this way gives the government far more latitude than the American President and his Cabinet have to adjust fiscal policy to the needs and demands of the national economy. At the same time, the British and Canadian systems have drawbacks. Britain's graduated purchase tax, for example, may be used by the government in practice to stimulate or discourage particular industries according to their supposed social or economic value. A purchase tax of 50 per cent is imposed on such items as automobiles, cosmetics, perfumes, record players, radio and television sets. John Allen May, London correspondent of the *Christian Science Monitor*, reported on Jan. 19 that many British taxpayers were hoping the government would abolish the tax this year and substitute a more generalized tax on spending.

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[13] Erwin N. Griswold, "The Case for a Re-examination of the Income Tax Structure," *Harvard Alumni Bulletin*, Feb. 16, 1957, p. 399.

A graduated purchase levy often is cited as a tax device having maximum flexibility. If economic growth is desired, durable consumer goods in the luxury or semi-luxury class can be taxed heavily in order—so the theory goes—to release savings for investment in plant, equipment, and public improvements. Kenyon E. Poole, an economist, has asserted: "But this is an excellent instance of the element of political unreality in any course of action designed to focus attention on the purely stabilizing effects of taxation. Firms and workers whose livelihood is dependent on the production of goods and services bought at high levels of income would be a formidable pressure group against this tax policy." [14]

John Allen May has asserted that the British purchase tax has not operated as expected. "In practice, production has been reduced in the very industries where its potential is highest. Costs have been drastically increased. Wages have been inflated to cope with the higher price of taxed goods. Exports have fallen."

Depreciation and Flexible Taxation

INTRODUCTION of more flexibility in the individual income tax, desirable as it may be to provide a tool for economic stabilization, is viewed by some economists as less important than introduction of greater flexibility in the corporation tax system. It is contended that plant and equipment spending could thereby be influenced up or down to fit economic conditions. Tax incentives to increase spending on plants and tools appear particularly attractive as means of expanding manufacturing employment. Decline of such employment has been the foremost problem attending the three postwar recessions.

Depreciation in the value of fixed capital assets, brought about by wear-and-tear and obsolescence, amounts to consumption of capital and thus constitutes one of the costs of doing business. Unlike the costs of labor and materials, which are met as incurred, depreciation charges are spread

[14] Kenyon E. Poole, "Built-in Tax Flexibility and the Experience of the Fifties," *Tax Revision Compendium* (papers on broadening of the tax base, printed by House Ways and Means Committee), Vol. III 1959, p. 2339.

over the "useful life" of a wasting asset. The longer the useful life, the smaller the annual tax deduction on this account. The methods by which these charges are estimated and entered in the corporate balance sheet strongly affect decisions on replacement of plant and equipment.

Support for Revising Depreciation Allowances

President Kennedy, campaigning for election last Oct. 31 in Philadelphia, declared that the nation "must stimulate plant modernization programs." He added: "Wherever we are certain that tax revision—including accelerated depreciation—will stimulate investment in new plants and equipment, without damage to our principles of equity, we will proceed with such revision." Douglas Dillon singled out depreciation allowances in his appearance before the Senate Finance Committee, Jan. 11, as one of the fields in which he hoped the administration would make recommendations to the Congress. President Eisenhower, in his final budget message on Jan. 16, urged Congress to allow businessmen to depreciate plant and equipment more rapidly as a spur to new investment. He declared that "More liberal and flexible depreciation can make a major contribution toward neutralizing the deterrent effects of high tax rates on investment."

The new President told the National Industrial Conference Board, Feb. 13, that he would propose to Congress within the next few weeks "a new tax incentive for businesses to expand their normal investment in plant and equipment." Kennedy stressed the need to "start now to provide additional stimulus to the modernization of America's industrial plant." He pointed out that the average age of equipment in this country's factories was about nine years and was rising, whereas "in a dynamic economy that average should be falling."

A Kennedy task force on taxation, headed by Prof. Stanley Sterling Surrey of Harvard Law School, submitted a report to the then President-elect on Jan. 9 which may have an important bearing on administration proposals for depreciation reform. Details of the report were not officially disclosed, but one recommendation was said to be aimed at stimulating business expansion by providing an "investment credit" that would cut a company's tax bill as its total investment expanded.

Under this plan, a corporation would be allowed a tax credit equivalent to a percentage of the amount by which its investment in new plant and equipment during the year exceeded its current depreciation deduction. This would be a credit against the final tax and not, as is the case with ordinary depreciation, a deduction from taxable income. Thus its value to the taxpayer would be greater.

If, for example, a company with a $2 million investment in plant and equipment which it was depreciating at a rate of $200,000 a year decided to double the investment in a single year, it then could credit a percentage of the sum of $1.8 million (excess of the additional $2 million investment over the $200,000 depreciation deduction) against its tax bill for that year. The *Wall Street Journal* reported, Jan. 10: "This approach, according to the task force, has several advantages over the more usual recommendation of larger annual depreciation allowances. For one thing, it spurs expansion in investment rather than replacement of existing plant and equipment. Moreover, it is highly flexible—the percentage credit can be raised or lowered or even removed depending on how much the administration wants to stimulate investment."

Objections to More Liberal Depreciation Policy

The tax credit plan may have somewhat more appeal for organized labor than proposals for accelerated depreciation. Labor fears that speeding up of depreciation of plant and equipment will only hasten the trend toward automation and further loss of jobs. In its legislative recommendations to Congress, Jan. 13, the A.F.L.-C.I.O. executive council listed "excessive depletion and depreciation allowances" among "unwarranted tax loopholes" that should be closed. Testifying for the A.F.L.-C.I.O. before the Joint Economic Committee of Congress, Feb. 9, Walter P. Reuther, president of the United Auto Workers, strongly endorsed proposals for a cut in the individual income tax, but strongly objected to the President's as yet undisclosed proposals to extend more favorable depreciation allowances to corporations. He said consumption, not investment, was the area in which support was needed at the present time.

Earl R. Rolph, professor of economics at the University of California, has stated that proposals for variation in depreciation allowances should be rejected "because they violate equity considerations and cannot be expected to pro-

vide the contra-cyclical effect" attributed to them. "Furthermore, once the door is opened for tax concessions to particular groups on grounds of stabilization objectives, it is politically difficult to prevent others from requesting that they too be permitted to promote the public interest in such a pleasant fashion. In this game, the dice are loaded in favor of well-organized groups at the expense of the general public." [15]

One of the principal objections raised against any increase in depreciation allowances is that it will cut into the amount of current collections from the corporate income tax. However, a survey of Canada's postwar experience with faster tax write-offs concluded that liberalization of depreciation allowances had not, in final result, impaired government revenues. "In 1952, when the [Canadian] government was in need of revenue, the effective [corporate] tax rate was about 51.3 per cent and depreciation was 44.1 per cent of corporate profits before taxes. In 1959, depreciation was 63.9 per cent of corporate profits before taxes but the effective tax rate had been reduced to 43.9 per cent. At the same time, collections of corporate income taxes had increased 11 per cent. In this country we have been unable to decrease the rate of corporate tax since the end of the Korean War." [16]

West Germany's Experience With Liberal Policy

A special committee of the Investment Bankers Association reported last November that a major factor in West Germany's postwar industrial progress had been "the freedom that corporations have enjoyed in charging depreciation reserves to earnings as they saw fit." The report said this freedom had provided both the incentive to build new and efficient plant and a large part of the means of financing it.

Regular depreciation rates in West Germany generally are determined in light of the particular circumstances of each corporate taxpayer, but in 1958 allowable rates were published as guidelines. Taxpayers may use higher rates if they can justify them. The First National City Bank of New York last September compared the German depre-

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[15] Earl R. Rolph, "Built-in Flexibility and Monetary Management," *Tax Revision Compendium* (Vol. III 1959), p. 2353.

[16] Maurice E. Peloubet (New York tax accountant), "What Would Depreciation Reform Cost?" *The Tax Executive*, October 1960, p. 41.

ciation rates with the American rates. For machinery in 1960, a basic rate of 10 per cent was common for straight-line depreciation in West Germany, compared with 6 2/3 to 4 per cent in the United States. But under a declining balance formula, this could be increased by a multiplier of 2½, thus giving a write-off of 25 per cent in the first year and of about 58 per cent of cost in the initial three years, compared with 13 1/3 to 8 per cent in the United States. The West German multiplier was pared to 2 at the beginning of 1961 as a brake on what was deemed excessive investment activity.[17]

The frequent changes in depreciation formulas in the major industrial foreign countries enables them to exercise a flexible control over economic growth. Congress made the last substantial revision of American depreciation policies in 1954. At that time it prescribed new formulas continuing fast tax write-off programs for defense-connected industries that had been instituted during the Korean War. A compelling consideration was to get business out of the slump it was then experiencing.

The accelerated depreciation provisions were curtailed in 1957 by an amendment to the Internal Revenue Code. Issuance of Office of Defense Mobilization tax write-off certificates was limited after Aug. 22, 1957, to new and specialized items of military, experimental, research or developmental equipment sold to the Defense Department or the Atomic Energy Commission in connection with national defense programs. The legislation terminated issuance of all amortization certificates as of Dec. 31, 1959.

Advocacy of Greater Administrative Flexibility

At present, the useful life of various types of capital assets is set forth by the Internal Revenue Service in a rule widely known as *Bulletin F*. Businessmen complain that a machine's usefulness to one company is not necessarily the same as to another because the development of a new or better machine can reduce an old machine's usefulness long before it wears out. The Internal Revenue Service, however, has interpreted the rules rather strictly.

President Eisenhower, in his budget message last year,

[17] Under the straight-line method of depreciation, American taxpayers deduct from taxable income the cost of capital assets evenly over the useful life of the asset. Under the declining-balance formula, the taxpayer may double the straight-line deduction in the first year. The deduction in the second and subsequent years remains at the doubled rate of the undepreciated balance, but the actual amount declines at a constant rate. See "Fast Tax Write-Offs," *E.R.R.*, 1957 Vol. II, p. 595.

said that administration of the depreciation provisions was being hampered by attempts of some taxpayers to claim excessive depreciation before disposing of their property. If the gain from sale of depreciable property were treated as ordinary income at the 52 per cent rate, not as a capital gain at the 25 per cent rate as at present, "the advantage gained in claiming excessive depreciation deductions would be materially reduced and the taxpayer's judgment as to the useful life of his property could more readily be accepted." Treasury Secretary Anderson announced that more flexible administration of the depreciation timetables would be ordered immediately if Congress agreed to the change recommended by the President. In fact, he indicated that the Treasury would like to experiment with more flexible administration before deciding whether a major statutory overhaul of depreciation requirements was needed.

A bill to carry out the Eisenhower proposal to tighten the rules on resale of business equipment was introduced in Congress, and hearings were held by the House Ways and Means Committee, but no further action was taken. A recent Treasury Department poll of 3,000 companies, released in preliminary form on Jan. 4, showed that most of the companies were willing to pay a higher tax rate on income from sale of equipment, in exchange for greater freedom in calculating tax deductions for equipment depreciation. About 65 per cent of the large firms and 59 per cent of the small businesses indicated that liberalized depreciation would materially influence their investment decisions in a manner which would increase their capital investments.

Freedom to set useful lives and choose depreciation methods, as long as they were applied consistently, was the approach most favored by both large and smaller businesses. Not all businesses were reported to want to write off plant and equipment within a year or some other relatively short period because this would cut too heavily into profits in the early stages and boost tax payments later. Rather, proponents of depreciation reform said, it reflected a desire on industry's part for more flexibility in the application of conventional methods as they affected particular company situations.

Amid the agitation for depreciation reform, scant attention has been given to proposals that actual tax rates on

corporation income be moved up or down in accordance with economic trends. Not only is it politically difficult to change the 52 per cent rate without making concessions to the individual taxpayer, but some legislators and economists believe Congress can exercise greater control over uses to which corporations put any increased income by opening the backdoor approach of depreciation liberalization.

Tax Simplification and Tax Flexibility

MANY tax experts believe that before the American tax system can be made a flexible instrument of policy it will have to undergo a sweeping revision to wipe out existing inequities and distinctions among sources and uses of income. Herbert Stein, research director of the Committee for Economic Development, has pointed out that what might seem to be a simple increase or decrease of tax rates under the present tax system would in fact pose a number of complicated questions. "For example, if it is fair that the maximum capital gains rate should be 25 per cent when the first bracket rate on ordinary income is 20 per cent, is the capital gains rate still fair and necessary when the first bracket rate is changed to 15 or 25 per cent? It is not possible with our system to keep everything else constant and change the rates because changing the rates changes the significance of too many distinctions in the tax system." [18]

Stein asserts that the "great rigidity" of the American tax system stems in part from disagreement among various powerful groups on methods of reform. Each of several groups believes the tax system must be changed, but their ideas of the necessary changes are not consistent with each other. None of these groups has sufficient strength to force the tax reform it wants through Congress, but several are strong enough to prevent any tax change that does not satisfy their ideas of reform. "Any opening up of the tax question, such as would be involved in an attempt to increase or decrease the revenue, would open up the wide disagreements about the existing system. No one

[18] Herbert Stein, "What's Wrong With the Federal Tax System?" *Tax Revision Compendium* (Vol. I 1959), p. 108.

could foretell what the outcome of the inevitable struggle would be, and there is a kind of tacit agreement not to precipitate such a fight, but to stick with what we have." [19]

CLOSING OF LOOPHOLES TO FACILITATE RATE CHANGES

Douglas Dillon told the Senate Finance Committee on Jan. 10 that initial Kennedy administration efforts probably would be directed toward closing tax loopholes rather than effecting a broad reduction in tax rates. "If you are going to cut over-all rates, you can do this only after closing whatever loopholes there are."

The unpublished Surrey task force report is said to call for introduction of a program of "basic reform" in income, estate and gift taxes to eliminate or lessen existing tax preferences combined with appropriate reductions in tax rates. Other influential groups have made similar recommendations. A report on "The Challenge to America: Its Economic and Social Aspects," prepared by a panel of the Special Studies Project of the Rockefeller Brothers Fund, Inc., said on April 20, 1958: "Experience strongly suggests that the nation would be better served by an income tax with somewhat lower rates that would apply more equally among persons with the same income."

The personal income tax has been severely criticized for unequal treatment of similar incomes. The Treasury Department reports that personal income tax returns filed in 1960 for the year 1959 showed total adjusted gross income of $305.7 billion, of which only $167.1 billion was taxable after all deductions, exemptions and exclusions had been taken into account. Most of the reform proposals offered during House Ways and Means Committee hearings on tax revision in late 1959 were aimed at various of these deductions and other tax preferences.

Proponents of tax revision assert that revenue gained by thus expanding the tax base would more than make up for losses that would result from scaling down individual income tax rates, which now start at 20 per cent and rise to 91 per cent in the highest bracket. Kenyon E. Poole wrote in a paper submitted to the committee:

> Both equity and built-in flexibility would be served by the elimination of some (though by no means all) of these mitigating

[19] Chairman Wilbur D. Mills (D Ark.) of the House Ways and Means Committee said, Jan. 25, he doubted that a start could be made in revising the income tax before 1962.

[exemption and deduction] provisions. The point is that if they were removed, it would be possible to effect a reduction in the nominal rate structure. This would be desirable from a number of points of view; but in the present context the advantage would be that room would be provided for some increase in income tax rates in the event that there was a need for a rise in tax revenues great enough to call for additional taxes or higher tax rates.

Other economists have likewise noted that income tax rates now are so high that it is politically impossible to increase them except under conditions of dire emergency. Removal of only one or two of the tax preferences complained of would be likely to lead to even greater inequity among the various groups taxed. A major revision is therefore recommended, combined with a lowering of rates to offset in part the higher effective rate of taxation in the absence of tax shelters built up over the years. John Kenneth Galbraith believes, however, that public opinion is not prepared either for the closing of all loopholes or downward revision of the surtax brackets. "There will, indeed, be a coalition of conservatives and liberals—the first defending the loopholes and the second the surtax rates—to forestall reform."

Use of Formulas in Applying Flexible Tax Policy

Assuming the political acceptability of automatic variations in tax rates, the question arises as to what signals should be used to call the variations into action. A number of indexes of economic activity have been suggested: the monthly report on unemployment issued by the Labor Department, the Federal Reserve Board monthly index of industrial production, the Consumer Price Index and various payroll, investment and inventory indexes.

Economists fear that all the indexes have serious defects as true indicators of economic conditions. The Consumer Price Index would be of little use as a guide to anti-recession policy; since World War II the annual index has moved downward only in 1949. The unemployment index is most often nominated as the signal caller. But it has been noted that a major difficulty in using this index as the sole guide is that, depending on the reason for fluctuations in unemployment, no action at all may be called for, or action may have been needed at a period prior to the appearance of substantial unemployment.[20]

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[20] Secretary of the Treasury Dillon said, Feb. 9, that no "one particular benchmark" would be taken by the present administration as the signal for action.

Automatic flexible tax formulas have a strong appeal because, as Earl E. Rolph told the Ways and Means Committee, "they promise fast results without dependence upon the fallibility of human intelligence." Rolph believes that "financial chaos" would be invited by reliance upon such automatic devices without the intervention of intelligent direction. "No amount of tinkering with the revenue system to make it more sensitive can take the place of the application of deliberate management in the conduct of our financial system."

The whole concept of tax flexibility by formula has been challenged on the ground that the budgetary process would be weakened and fiscal irresponsibility encouraged. If, for example, rates of taxes were raised to curb private spending when inflation threatened, what would prevent a corresponding increase in government spending to absorb the increased revenues? Or if taxes were cut to head off a recession, how could they be got back to previous levels once the danger had passed? Harry L. Lutz, representing the National Association of Manufacturers, expressed the viewpoint of this school of thought when he told the Ways and Means Committee, Dec. 18, 1959: "In view of the weight of the tax burden and the necessary complexity of the tax structure that must impose this burden, tax rate changes should only be made in the open, after proper hearings and notice to all concerned. Taxpayers should not be whipsawed by the arbitrary action of either an administrative official or an impersonal formula, with no opportunity to offer testimony or rebuttal in their own defense."